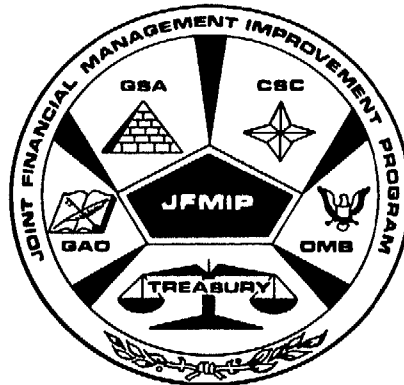


OPERATING BUDGETS



A PRACTICAL APPROACH



**THE JOINT FINANCIAL MANAGEMENT
IMPROVEMENT PROGRAM**

NOVEMBER 1975

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JOINT FINANCIAL MANAGEMENT IMPROVEMENT PROGRAM

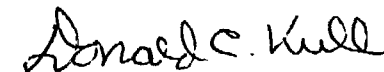
The Joint Financial Management Improvement Program was authorized by the Budget and Accounting Procedures Act of 1950. It is a joint and cooperative undertaking of the Office of Management and Budget, the General Accounting Office, the Treasury Department, the General Services Administration, and the Civil Service Commission, working in cooperation with each other and with each of the operating agencies. The overall objective of JFMIP is to improve and coordinate financial management policies and practices throughout the Government so that they will contribute significantly to the effective and efficient planning and operation of governmental programs.

FOREWORD

This booklet is based on the report of an interagency study team which was appointed by the Joint Financial Management Improvement Program to study the "Use of Operating Budgets for Program Management." The members of this study team are listed in Appendix A.

The study team reviewed practices in a number of Federal agencies, with the assistance of Executive Management Service, Incorporated. The team members also drew on their own broad experiences in budgeting and other aspects of financial management.

It is clear that there is no one "right way" to use operating budgets to aid in the management of programs. Each agency must tailor its system to fit its own organization and management policies. The study team, however, has come up with a number of guidelines which I believe can be useful to many Federal agencies and other governmental organizations.



Donald C. Kull
Executive Director
Joint Financial Management
Improvement Program

OPERATING BUDGETS--A PRACTICAL APPROACH

INTRODUCTION

The term "operating budgets" as used in this paper refers to a short-term plan for managing the resources of an organization. Financial managers have long extolled the virtues of operating budgets and often lamented their improper or insufficient use in the Federal Government. As a consequence, the Government files are full of competently written, highly technical dissertations on "managing Federal resources."

Systems have been designed and installed. Some have succeeded; many have not.

Good management of all programs at all levels of Government carries with it the trust of proper resource management. No one can deny the fact and few will try. Why, then, don't more Federal managers look to their budget and accounting offices for assistance in carrying out this trust? One can only presume that the reasons go something like this:

- a) Many Federal programs have experienced fairly rapid growth over the years, and, since in some cases there has been no serious shortage of resources, there seemed to be no compelling need for tight management of these resources.
- b) Rules for the use of operating budgets seem to be designed "for somebody else" because they often are written to achieve a uniformity of approach among markedly different programs and are not flexible enough to appeal to the manager of a unique program.
- c) Operating budgets seem to be an accounting tool for the use of accountants. The program manager rationalizes, "Neither the Budget and Accounting Procedures Act of 1950 as amended, nor the Anti-Deficiency Act on overspending has any direct impact on my program because the budget staff will get the funds and the accountant will control costs."

d) Major attention in Federal budgeting has usually been on formulation of appropriation requests rather than on budget execution. When attention has been given to budget execution, the emphasis usually has been on avoiding over-obligations. Only a few Federal agencies have made effective use of internal operating budgets to assist in management of agency programs.

e) Many program managers have become frustrated and discouraged in attempts to use operating budgets because accounting systems in many agencies throughout Government are not providing timely financial data to track against the budget.

f) Top management has not shown much interest in operating budgets.

g) Late enactment of appropriations tends to create uncertainties, frustrate the manager, and thus inhibit planning and use of operating budgets.

In summary, many program managers have been "turned off" because they have not seen anything in the process of using operating budgets to benefit them, and they do see a complex dollar-oriented burden added to their already-full agenda.

Indeed, many existing operating budget systems fall short of serving managers well. Recognizing this, the Executive Director of the JFMIP appointed a study team of top-level financial managers to explore the "Use of Operating Budgets for Program Management." The team represented a cross section of experience and involvement in major Federal programs including the General Accounting Office, the Atomic Energy Commission, the General Services Administration, the Civil Service Commission, and the Departments of Treasury, Agriculture, Labor, and Health, Education and Welfare.

In the Executive Director's instructions to the team, he stated that "while some Federal agencies have made very effective use of internal operating budgets to assist in management of agency programs, this management tool has not been used as extensively or as effectively as might be possible."

The group was asked to draw up a set of guidelines for managers to use in determining when and how to use operating budgets.

REVIEW OF EXISTING SYSTEMS

The team was first faced with deciding how to proceed. An early decision had to be made as to the depth and breadth of research necessary to draw the proper conclusions. Since the range of different possibilities was so great, given the scope of Federal governmental operations, and since it was felt that research in depth might well cloud the broader issues with minutiae, the team decided to base its findings on a relatively broad look at a representative group of Federal agencies which have been using operating budgets.

The team then reviewed the use being made of operating budgets in thirteen constituent organizations within six Departments and two Agencies. This review included a comparison of each organization's published procedures with a set of factors that the team believed might be useful in developing and utilizing effective operating budgets. (See Appendix B)

Representatives of the team followed up with the organizations to see how the systems were really operating in comparison with their published procedures. Several points were apparent:

General Findings

1. All managers contacted strongly supported the concept of operating budgets.
2. There was, understandably, a significant lack of uniformity in the ways budgets were developed and performances were tracked and in the levels to which reports were made.
3. Most of those questioned felt that operating budgets were usually a "by-product" of the existing accounting, budgeting, and management systems and that techniques employed in tracking performance--while they varied among the agencies--were generally satisfactory. At least three agencies had very effective procedures and three other agencies had

effective systems at the operating level but results were not made known to, or used by, top agency staff. The team did not obtain enough information from the remaining seven organizations to evaluate their effectiveness but did obtain useful data from them.

Some Common Factors:

- All organizations covered by the study reported that operating budgets were prepared prior to, or early in, the fiscal year, and that budgets were usually prepared and/or issued to all program-level and field units of the organization. Almost half of the organizations develop budgets for units below the major program level and below the Regional level.
- Most of the organizations reported that the lack of timely Congressional action on their appropriation requests caused a major problem in developing operating budgets that had any continuity. There seems to be a general inability to adjust to this situation. These organizations had to prepare budgets based on anticipated funding levels under a continuing resolution to be revised when the appropriation was subsequently received. Operating budgets are usually updated every three or four months thereafter.
- All budgets had monthly or quarterly dollar levels (obligation or cost targets). All budgets were reviewed on a monthly basis.

Some Differences:

- Five organizations prepare operating budgets on a cost basis, one uses accrued expenditures, and five prepare their operating budgets on the basis of obligations. Two use obligations for their grant programs and costs for administrative operations.
- Seven organizations have relatively simple funding sources--primarily a single appropriation. Two reported they had multiple appropriations to consider in developing their operating budgets.

--Only five of the organizations related dollars to performance units in the operating budgets. The remainder compare actual dollars against the budget plans with no production or performance data reported.

--Several organizations with scientific, medical and educational programs reported that output measures often could not be used, but that work plans by projects/tasks, milestones, or man-months required to complete could be used in conjunction with the budget plan to provide the necessary management control.

--Although operating budgets are structured in a variety of ways, the most common is by budget activity and sub-activity within an appropriation. Variations depend on the operating and management patterns of the organization. Some variations are:

- Dollars and work units tied to work authorizations
- Dollar plans related to program goals and workloads
- Dollar plans related to organizational staffing patterns and identifiable workloads
- Dollar plans related to grant programs or to specific organizational entities.

--One of the most important differences noted in the review was the level of reporting performance against the plan. While most of the organizations' procedures require progress or status reporting to top management, the review indicated that reports usually reached the middle manager only--with little or no feed-up, even on an exception basis, to top management. Officials in several organizations noted this as a weakness.

The subject of operating budgets is a complex one, but officials in each of the organizations included in the review agreed that they are vitally necessary in order to make sound, dollar-based program

decisions. Any system can be useful if it meets the needs of top managers and produces reliable data.

PREPARATION OF GUIDELINES

The guidelines which follow reflect both information gathered through the review process and the experience of team members. They are written for that executive who may not be financially trained or oriented but who does need a basic understanding of operating budgets. While the guidelines may suffer from over-simplification in the eyes of the financial expert, it is believed that they are complete enough for those program executives who have a need to understand better how operating budgets are developed and used.

GUIDELINES

A simple decision that says, "we need an operating budget," leads to a series of questions that must be answered logically, or the base decision will not achieve reality. The questions are these:

What is an operating budget?

Why is it needed?

Who needs it?

What does it cover?

How do I design it?

How do I use it?

What are some of the pitfalls to avoid?

Where can I get help?

What is an Operating Budget?

It is a short-term plan for managing the resources necessary to carry out a program. This definition is necessarily broad because of the broad range of possibilities. "Short-term" can cover anything from a period of weeks to a couple of years but in the Federal Government operating budgets are usually developed for one fiscal year with changes made when necessary. An operating budget should facilitate comparisons between planned and actual consumption of resources and accomplishment of goals.

All departments and agencies prepare an estimate for inclusion in the President's budget, and most assert that they have operating budgets as well. In reality, however, the latter often has no relation to the former. The so-called operating budgets of some agencies are little more than an apparatus by which new obligational authority is distributed among agency organizations. These budgets are essentially oriented to fund control rather than operations control. Thus, they have the name but not the substance of a true operating budget.

Why is it needed?

An operating budget is needed so that an organization knows at all times:

- Who is responsible and accountable for performing the work (organizational identification)
- What work is to be performed (outputs)
- What resources (inputs) are needed to produce the outputs
- What resources are available

When plans and estimates are coupled with feedback concerning the actual results, managers have information that is essential to the performance of basic managerial functions.

A successful program manager knows what is expected of him by his superiors. He knows what resources, including dollars and manpower, he has and will have at his disposal, how the accomplishments will be measured, and how often his accomplishments will be reviewed. He knows how to plan and to carry out his responsibility effectively and is, at all times, able to respond to the review-and-approval hierarchy. This is the effective use of the operating budget.

Who needs it?

Anyone who is responsible for a Federal program and is accountable for the resources assigned to carry out the mission. Anyone who must make managerial decisions that have an impact on resources. This includes most managers in the Federal Government--first-line managers, middle managers, and top managers.

What does it cover?

An operating budget should include all resources that are necessary to carry out a program (funds, staff, equipment, supplies, space, other resources,

and workload). An elaborate cost system, while vital to the control of some functions, may not be necessary in all cases. Simple obligations will suffice for some and, in the most rudimentary cases, personnel controls might well be sufficient, i.e., the small office that involves a simple mission, a budget that is 90 percent personnel costs, and only one source of funds. The manager of such a function controls his resources when he manages his staff by controlling hiring, promotions, salaries, and overtime against his available personnel dollars. Other items such as space rental, equipment, and supplies are directly controllable. His principal concern is to get his mission or function accomplished with the personnel available. He can keep close track of his operations through his daily contacts and analysis of any periodic fund reports available.

Many program managers are faced with more complex situations. Some have a major program or program segment that involves both a staff operation and a major program function. In such cases, only a portion of the costs may be directly under a manager's control, and he must depend on others below him to see that the program function is carried out and resources properly used. His primary means of control is a reporting system to monitor the operating cost or obligation targets, to determine that resources are effectively used, and to see that the program objectives are achieved. The manager at the top and the manager at the operating level both need good planning to achieve this objective.

Managers at all levels need to be concerned with timely program planning and with directing and controlling operations.

--Timely program planning means determining objectives and priorities and relating them to resources. When planning data are late and resources are subject to last minute cuts and shifts in program priorities, the purpose is defeated.

--Directing and controlling operations may involve a number of different techniques. The commitment of resources and shifting of resources, as priorities or objectives change, present a constant challenge. Flexibility is

helpful to a manager. The best manager is one who is in effective communication with both his staff and his superiors. He can anticipate and prepare for changes. He is aware of production or performance problems and moves to shift resources promptly to meet the challenge. The operating budget to him is not a formal, static document, but a record and projection of what can be achieved if he can manage his resources properly. To meet the challenge, he must be alert to alternate methods which might accomplish work on a shorter schedule or at a lower cost.

How do I design it?

The first thing to be determined is which operations should be controlled and measured through the use of operating budgets. The identification of these operations should be accomplished coordinately with the budget, accounting, and program staffs.

Usually, as a minimum, an operating budget should include each activity within an appropriation and each major program category within an organization. There will usually be a further breakdown below the budget activity level. In those agencies where historical development has led to a series of discrete and unrelated categories (e.g., when the appropriation structure is not consistent with the program structure or the organization structure), efforts to bring them all into agreement will pay off in better and easier management.

The second thing to do is to define clearly the elements included in the operating budgets.

Third, the measurable units of output should be determined, if feasible, agreed upon, and used in the operating budgets.

Fourth, depending upon needs, a decision should be made as to whether the operating budgets and the reports of actual performance should be on an obligation, cost, accrued expenditure or cash basis.

If measurable units of outputs have been determined or if there is a need to obtain reimbursement, the cost basis should be used as none of the other bases

necessarily relates to the time period in which the work is performed (obligations and accrued expenditures could precede the period in which the work is performed and the cash disbursement usually occurs in a later period). Cost is the only financial measure which coincides with the period in which performance occurs. The cost of a unit is determined by the resources applied to its accomplishment regardless of when the obligation occurred, the goods or services were received, or when the bills were paid. Work performance comparisons between time periods, between organizations, or between supervisors are most valid when the cost basis is used.

Fifth, the format of the operating budget and performance reports, comparing actual with planned, both as to dollars and units of accomplishment, should be agreed upon.

Sixth, the period of time covered by the budgets and reports should be decided. Normally, monthly reports are needed but there may be some situations where more or less frequent reporting should be used.

The most important step in installation is commitment. All parties who are involved in the use of operating budgets must be committed to the project. This requires training, involvement in decisions, and presentation in such a manner that everyone can readily see "what's in it for me." A unilateral decision can result in a poorly controlled project.

How do I use it?

One thing very clear in a recent survey was that no two managers use the operating budget the same way.

Some use it solely as a planning document, simply for getting a plan down on paper and then forgetting it. Others use it primarily as a dollar score card, to see how close they come to meeting costs, plans, or objectives. Most of those interviewed, however, really try to make effective use of the operating budget to plan, to control, and to evaluate program performance. They are concerned about making effective decisions in today's environment with constantly

increasing costs and the pressures for decreasing Federal spending wherever possible.

Several expressed the need for better and more responsive reports as a basis for decision-making and program control, the two factors that make operating budgets important to them as they are faced with overwhelming workloads, reduced resources, and constantly increasing costs. They must make responsive decisions on a variety of matters to carry out responsibilities that involve the expenditure of public funds for a wide-ranging group of Federal programs. Their decisions have a real impact on whether the programs are successful or not.

Simple analyses often work best. A comparison of actual experience to plans will usually highlight trends and matters that require more in-depth review.

Variance analysis--between planned and actual--provides an early warning system and may be traced from higher to lower organization and program levels. Variances are not necessarily indicative of problems, but managers have indicated that variance analysis is a useful tool.

The managers interviewed were constantly seeking to improve their techniques for planning, analyzing, and controlling costs and performances. Several were concerned about the lack of incentives to spur the line manager to improve his operation. Highlighting major variances in management meetings has proven to be an important technique for several agencies. This has occurred where the accountant, the production man, and the project manager can evaluate and analyze the problem together and agree jointly on corrective action.

There are other techniques and much has been written on scientific management, management by objectives, quantitative analyses, modeling, etc. Managers have different techniques with a common objective--to get the job done on schedule at the least cost.

What are some of the pitfalls to avoid?

An operating budget can

- become unmanageable to top managers, middle managers, and first line managers if it is not designed to meet the needs of each level of management.
- be too complex and detailed to be readily understood. Managers may then set it aside as cumbersome and useless.
- be too late or too inaccurate for use in decision-making. Timely data with minor inaccuracies are more useful than accurate data available months after the decisions had to be made.
- be out-of-synchronization with the accounting system, which may not be geared to produce the right kind of actual data to use in tracking against plans. This continues to be one of the major problems in the Federal sector. Many agencies simply do not have accounting systems that produce timely management reports. Too many systems are geared solely to meet government-wide fiscal reporting needs.
- be out of touch with the rest of the budget process - operating in a sort of budgetary vacuum.

So, whether the agency has a cost system or an obligation system, it must have a relatively simple way to plan and track the dollar impact of its programs. Several illustrations of reporting formats used by some agencies for operating budgets are shown in Appendix C.

And most important--the executive who decides to install an operating budget can become too busy with other things and not use it. It will only function if top management makes it work by using it and supporting its use throughout the organization.

Where can I get help?

The Management Sciences Training Center of the Civil Service Commission offers a number of financial management training courses which are available to all agencies.

Questions on use of operating budgets may be addressed to the Executive Director, JFMIP, 666 Eleventh Street, N.W., Suite 705, Washington, D.C. 20001. The JFMIP can serve as a clearinghouse to refer agencies wishing to improve their use of operating budgets to other agencies with relevant experience.

APPENDIX A

JFMIP STUDY TEAM ON
OPERATING BUDGETS

*Richard E. Miller, Chairman
Comptroller, Department of Labor

Steve L. Comings
Assistant Commissioner, Comptroller
Bureau of Government Financial Operations
Department of the Treasury

*Victor Corso
Deputy Assistant General Manager, Controller
Atomic Energy Commission

David Dukes
Deputy Assistant Secretary for Finance
Department of Health, Education and Welfare

Palmer Marcantonio
Office of Financial Management
General Services Administration

Richard Maycock, Deputy Director
Financial and General Management Studies Division
General Accounting Office

Jerome Miles, Director
Office of Budget and Finance
Department of Agriculture

J. Edward Murphy, Director
Financial Management Training
U.S. Civil Service Commission

Leslie D. Thorn, Assistant Comptroller
Financial Policy & Systems
Department of Labor

Charles Troell, Assistant Controller for Accounting
Energy Research & Development Administration

*Retired from Government service.

FACTORS TO CONSIDER IN DEVELOPING
AND USING OPERATING BUDGETS

1. Preparation Timing
 - Under a Continuing Resolution
 - After a Congressional appropriation enactment
 - Revision
2. Level of Preparation and/or Issuance
 - Headquarters
 - Regions
 - Field offices
3. Financial Basis
 - Obligations
 - Costs
 - Accrued expenditures
 - Outlays
 - Cash
4. Sources of Funding
 - Direct
 - Reimbursable
 - Multiple appropriations
 - Revolving fund and other receipts
5. Financial Data and/or Quantified Work Unit
 - Programs
 - Activities
 - Objects
6. Personnel Ceilings
7. Manpower Measures
 - Man years
 - Man months
8. Level of Reporting
 - Integrated
 - Pyramid
9. Review Frequency

SAMPLE REPORTING FORMATS
FOR OPERATING BUDGETS

NOTE: These are some of the reporting formats which agencies have found useful for operating budgets. Each agency should develop the format which best serves its own management purposes.

FINANCIAL MANAGEMENT REPORTING SYSTEM
FOR MONTH ENDING _____
COSTS AND OBLIGATIONS BY APPROPRIATION AND BUDGET ACTIVITY

ADMINISTRATION:

APPROPRIATION	BUDGET ACTIVITY	CURRENT MONTH COST	Y E A R - T O - D A T E			
			COST	COST PLAN	OBLIGATIONS	OBLIGATION/LIMIT

Costs and Obligations by Budget Activity

This summary provides a comprehensive financial status of budget execution in terms of costs and obligations. The data is displayed for each Appropriation and Budget Activity and for the total of all appropriations. It also provides for unfunded costs to be reported. It is prepared and summarized for each level of management. This report provides the manager with:

--Actual cost of operations by major activity.

--Obligations in relation to the current fiscal year budget.

--A ready reference to the plans, both cost and obligations,
for the fiscal year to date.

When the cost or obligation amounts for a specific appropriation vary significantly from plans, variances can be identified and referred to managers for review and explanation.

APPENDIX

FINANCIAL MANAGEMENT REPORTING SYSTEM
FOR MONTH ENDING _____
PROGRAM COSTS AND HOURS

ADMINISTRATION:

PROGRAM		CURRENT MONTH	YEAR-TO-DATE			ANNUAL PLAN
Number	Description		Plan	Actual	Variance	
	<u>COST DATA</u> (List programs)					
	<u>HOURS DATA</u> (List programs)					

FINANCIAL MANAGEMENT REPORTING SYSTEM
FOR MONTH ENDING
PROGRAM PERFORMANCE - COSTS AND HOURS

ADMINISTRATION:

PROGRAM NO.	NO.	PERFORMANCE FACTOR	CURRENT MONTH COST	CURRENT MONTH VOLUME	YEAR-TO-DATE		ANNUAL PLAN	
		DESCRIPTION			COST	VOLUME	COST	VOLUME
412		<u>COST DATA</u>						
	1	Wage Standards	\$XXXXXXX		\$XXXXXXX		\$XXXXXXX	
	2	Employees Helped		XXXXX		XXXXXX		XXXXXX
	2	Investigations		XXXXX		XXXXXX		XXXXXX
	41210	Minimum Standards-Low	XXXXXXX		XXXXXXX		XXXXXXX	
		Wage Workers						
	1	Employees - Income Gained		XXXXX		XXXXXX		XXXXXX
	2	Investigations		XXXXX		XXXXXX		XXXXXX
PROGRAM NO.	NO.	PERFORMANCE FACTOR	CURRENT MONTH HOURS	CURRENT MONTH VOLUME	YEAR-TO-DATE		ANNUAL PLAN	
		DESCRIPTION			HOURS	VOLUME	HOURS	VOLUME
412		<u>HOURS DATA</u>						
	1	Wage Standards	XXXXXX		XXXXXX		XXXXXXX	
	2	Employees Helped		XXXXXX		XXXXXX		XXXXXX
	2	Investigations		XXXXXX		XXXXXX		XXXXXX
	41210	Minimum Standards-Low	XXXXXX		XXXXXX		XXXXXXX	
		Wage Workers						
	1	Employees - Income Gained		XXXXXX		XXXXXX		XXXXXX
	2	Investigations		XXXXXX		XXXXXX		XXXXXX

APPENDIX C

COST-BASED OPERATING PLAN

TO : (Allowee)	Approved By Allottee	Date
FROM: (CBOB Manager) (signature date)	Approved By Allowee	Date
	Cost Center	X X X X X X X X

	Cost in Thousands											
	1st Quarter			2nd Quarter			3rd Quarter			4th Quarter		
	July	Aug	Sept	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	June
	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX
				XXX					XXX			
Month Plan A/												
Quarterly Plan												
Annual Plan												XXX

A/ This plan will be further broken down when applicable by salaries and expenses of direct operations activities, controllable costs, uncontrollable costs, funded cost, unfunded cost and capitalized costs. Other suitable captions may also be used.

[illegible]

COST BUDGET REPORT
PROGRAM SUMMARY
AS OF _____
IN THOUSANDS OF DOLLARS

[illegible]

SUMMARY OF BUREAU OPERATIONS
FY _____ THROUGH _____

FULL YEAR PROJECTION COMPARED WITH BUDGET AND PRIOR YEAR

[illegible]

SAMPLE (CONTINUED)

SUMMARY OF BUREAU OPERATIONS
FY _____ THROUGH _____

YEAR TO DATE

FULL YEAR PROJECTION COMPARED WITH BUDGET AND PRIOR YEAR

C. RESOURCE REQUIREMENTS &
FINANCING (CONTINUED)

- | YEAR TO DATE | | | FULL YEAR PROJECTION COMPARED WITH BUDGET AND PRIOR YEAR | | | | | |
|--|-------------------------------|----------|--|-------------------------------|-----------------------------|-------------------------|---------------------------|-----------------------|
| Actual | Expense
Budget
Approved | Variance | Projected
Results
as of | Expense
Budget
Approved | Funded
Budget
Enacted | Prior
Yr.
Results | Variance | |
| | | | | | | | From
Expense
Budget | From
Prior
Year |
| d) Asset disposi-
tions: | | | | | | | | |
| 1. Gross book
value (-) | | | | | | | | |
| 2. Accumulated
deprec. | | | | | | | | |
| c) Subtotal, fixed
asset trans-
actions | | | | | | | | |
| 3) Unfunded liabili-
ties increase (-)
or decrease | | | | | | | | |
| 4) Special charges or
credits (-) to in-
vested capital | | | | | | | | |
| c. Subtotal - funded
accrued expenditures | | | | | | | | |
| d. Funds applicable to
undelivered orders,
increase or decrease
(-) | | | | | | | | |
| e. Subtotal - Oblig. in-
curred | | | | | | | | |
| f. Funds to be oblig. or
written-off | | | | | | | | |
| g. Effect of rounding | | | | | | | | |
| h. Total resource
requirements | | | | | | | | |